83-555

FILED
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ALEXANDER L. STEVAS,
CLERK

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

RUSSELL STOVER CANDIES, INC.
a Missouri corporation,

Appellant,

— v —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Appellee.

On Appeal from the Supreme Court of Montana

APPENDIX TO JURISDICTIONAL STATEMENT

WARD A. SHANAHAN
Counsel of Record
DANIEL C. MURPHY
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715
(406) 442-8560

Counsel for Appellant

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APPENDIX A

No. 80-375

IN THE SUPREME COURT OF THE
STATE OF MONTANA

1983

RUSSELL STOVER CANDIES, INC.,
Respondent and Appellant,

— vs —

DEPARTMENT OF REVENUE OF THE STATE
OF MONTANA,
Appellant and Respondent

Appeal from:

District Court of the First Judicial District,
In and for the County of Lewis & Clark, The Honorable Peter Meloy, Judge presiding.

Counsel of Record

For Appellant:

Ward A. Shanahan; Gough, Shanahan, Johnson & Waterman, Helena, Montana

For Respondent:

Terry B. Cosgrove; Luxan & Murfitt, Helena, Montana
Michael Rieley, Dept. of Revenue, Helena, Montana

Submitted: March 31, 1983
Decided: May 19, 1983

Filed: May 19, 1983
Ethel M. Harrison, *Clerk*

Mr. Chief Justice Frank I. Haswell delivered the Opinion of the Court.

The Department of Revenue (DOR) appealed the Lewis and Clark County District Court judgment reversing the State Tax Appeal Board's (STAB) determination that the Montana divisions of the Ward Paper Box Co. (Ward), appellant, now Russell Stover Candies, Inc., were taxable as part of a unitary business. The District Court held that assessment of income taxes based on appropriation of income was thus improper. This Court reversed the District Court decision. Russell Stover appealed to the United States Supreme Court which vacated our judgment and remanded the case to this Court for reconsideration in light of two United States Supreme Court cases decided subsequent to our decision.

We affirm our previous decision.

The facts are well stated in our initial opinion, Ward Paper Box Co. v. DOR (1981), __ Mont. __, 638 P.2d 1053, 38 St.Rep. 4147. However, they will be briefly set out here.

Ward filed Montana corporation license tax returns for 1971 through 1975 based on the segregated income from its Montana operations alone. DOR audited Ward's records, determined that Ward was a unitary business not entitled to separate accounting of its Montana operations and income, and assessed additional corporation license taxes against Ward by use of a three-factor formula which apportioned to Montana part of Ward's total income.

Ward protested this assessment to STAB which affirmed the assessment by DOR. Ward filed a petition for review in the District Court of Lewis and Clark County. On August 4, 1980, the District Court reversed the STAB deci-

sion. DOR appealed to this Court from the judgment of the District Court.

Ward was a Missouri corporation qualified and doing business in Montana, maintaining its principal place of business in Kansas City, Kansas. All of its common stock was owned by Louis Ward during the period in question. Ward's activities consisted of seven divisions; the divisions located outside Montana were involved in manufacture, sale and distribution of paper boxes and paper box products in the States of Kansas, Missouri, Colorado, South Carolina and Virginia. The Montana divisions consisted of two cattle ranches, one in Meagher County and one in Powell County.

For the years 1971 through 1975, Ward used the separate accounting method for filing its Montana tax returns and in each year paid the minimum corporation license tax of $50. During those years the operating costs and depreciation expenses of the Montana divisions exceeded the income earned by those divisions.

During the same time period, Ward filed tax returns under the unitary apportionment method in the other states in which it was operating, and the Montana ranch divisions were included as part of its total unitary business. In those states the losses sustained by the ranch divisions were used to offset income earned by the paper box divisions.

The facts regarding Ward's operations during the years in question are for the most part uncontested. The home office in Kansas City provided administrative services for all divisions of Ward's operation which included preparing federal and state reports, hiring the accountants to prepare tax returns, keeping the books, preparing financial statements and balancing checkbooks. Each of the divisions was charged an arbitrary figure of $60 per

month for the home office services. This figure was not based on the amount of time actually spent on each division by home office personnel.

Ward's divisions did not exchange equipment or personnel and did not purchase products jointly. There was no joint advertising program among the various divisions and no common salesmen.

There were two accounts maintained for each division, an expense bank account and a payroll account. Each division's expense bank account was maintained in a bank in Kansas City. Any monies generated by a division were deposited in that division's separate expense account. If the division did not immediately need the funds, they would be transferred from the separate division expense account into a general account and would be utilized wherever needed by any of the separate divisions. The president of the company would make the decision as to the transfer. Excess funds would be invested, if not needed by any of the divisions. A portion of the short-term investment income was attributable to funds generated in Montana, yet the portion attributable to funds earned in Montana could not be specifically identified or segregated.

If either of the Montana ranch divisions did not generate enough income to meet expenses, additional funds would be transferred from Ward's general account to the ranch division's expense bank account.

The payroll account for each ranch division was maintained in a Montana bank and checks could be written on this account by the ranch manager. However, the home office personnel maintained the records, balanced the books and made the deposits.

There was some central management of the corporation. From the evidence presented at the hearing, STAB

found that the home office made all of the decisions regarding the financial affairs of the corporation and that major decisions regarding the ranches, such as the purchase of equipment and the buying and selling of cattle, required the approval of the chairman of the board or the president of the corporation.

We reversed the decision of the District Court and held that the ranch divisions were part of Ward's unitary business.

Our decision was founded upon the statutory definition of a unitary business. Section 15-31-301(2), MCA, defines the unitary business principle. It reads:

> "(2) A corporation engaged in a unitary business within and without Montana must apportion its business income as provided for under 15-31-305. A business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as independent businesses."

This rule applied throughout the entire period of the dispute, first as an administrative regulation and then as the above statute in which that regulation was codified. We concluded from the facts of the case that Ward's operation within Montana was dependent upon and contributing to its operation outside Montana. Thus, taxing apportioned income of Ward's overall operation was not violative of the due process clause.

After our decision, Russell Stover Candies, Inc., acquired all interest in Ward. It then appealed to the United States Supreme Court.

The United States Supreme Court vacated the judgment and remanded the cause to this Court for further consideration in light of two United States Supreme Court cases: F.W. Woolworth Co. v. Taxation and Revenue Dept., New Mexico (1982), 458 U.S. __, __ S.Ct. __, 73 L.Ed.2d 819, 50 USLW 4457, and ASARCO, Inc. v. Idaho State Tax Commission (1982), 458 U.S. __, __ S.Ct. __, 73 L.Ed.2d 787, 50 USLW 4962.

We affirm our initial decision.

In both of the above cases, taxpayer corporations were appealing state court decisions allowing revenue departments to include income earned through investment subsidiaries in the total "business income" to be apportioned for taxing purposes. The Supreme Court determined that the subsidiaries were separate and discrete businesses and income from such entities could not increase the income of the parent corporation that was to be apportioned. Taxing such income was a violation of the due process clause as no relationship exists between income produced by subsidiaries and the value of transacting business within the state. Mobil Oil Corp. v. Commissioner of Taxes (1980), 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510; Moorman Mfg. Co. v. Bair (1978), 437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197.

In *ASARCO*, Idaho tried to levy corporation income taxes on the corporation based on income, increased by dividends, interest and stock sales from ASARCO's major interests in five foreign subsidiaries. The State Supreme Court approved this practice, and ASARCO appealed to the United States Supreme Court.

The Court applied the unitary business principle, best explained in *Mobil Oil*, supra. It found that the subsidiaries in question were separate business entities.

ASARCO had a majority interest in Southern Peru Copper Corporation, but due to a management agreement, it could not assume control of the subsidiary. Further, Southern Peru did not seek direction from ASARCO. The majority of MIM Holdings, Ltd., in Australia was owned by ASARCO, but no control was asserted nor did it elect any board members, appoint any officers or hire any staff. In two other subsidiaries, ASARCO only held minority interests, and the court held they were autonomous operations. Finally, the Mexican subsidiary was once wholly owned by ASARCO but a Mexican law forced it to divest 51 percent of its ownership.

Idaho urged the Court to expand the unitary business principle to include any income received by a parent corporation that would add to the general capital of that corporation. The Court refused this interpretation because it would result in taxing returns on any corporate investment as "business income," even though received from a totally independent entity.

The same general question was raised in *Woolworth*. The taxpayer corporation owned four foreign subsidiaries. New Mexico apportioned Woolworth's income for taxing purposes and included in such income dividends paid by subsidiaries. The corporation appealed the New Mexico Supreme Court's approval of this action.

As in *ASARCO*, the United States Supreme Court applied the unitary business principle and found the subsidiaries to be separate business entities. It determined that the potential to control is insufficient to find a unitary business. Moreover, mere financial advantage achieved from dividends does not warrant a finding that a subsidiary is part of a unitary business.

The Court concluded that the contribution to income did not result from functional integration nor centralization

of management. Functional integration was absent since the subsidiaries did all their own purchasing, staffing and training. Further, there was no centralized management. The subsidiaries had separate and distinct management personnel and training systems for such personnel. They made their own management decisions and determined their own policies. Each subsidiary catered to local needs and tastes. Each subsidiary was considered autonomous and thus a separate and discrete business.

There are certain factors that distinguish the present case from the cases decided by the United States Supreme Court. First of all, in *ASARCO* and *Woolworth*, the questioned income was derived from foreign investments in the form of subsidiaries. Here, the ranch divisions were active operations of Ward. Secondly, in form, each subsidiary is a separate and distinct business. Each had separate directors, officers and staff. On the other hand, the ranch divisions were formally part of the Ward corporation. They were subject to Ward's policies and directives and had to operate under the auspices of the board and officers. Third, and most important, there is a striking difference between the present case and the United States Supreme Court cases regarding the independence of the business entities.

In applying the standard utilized by the Supreme Court we must affirm our initial decision. To ascertain whether the subsidiaries were part of a unitary business, the Supreme Court had to determine whether there was functional integration and centralized management in the relationship between the parent and subsidiary. In other words, the Court focused on the relative independence of the subsidiary. In the case at bar, we find that the ranch divisions had very little independence from the overall Ward operation. The ranch divisions and Ward were

functionally integrated. Even though a specific product did not evolve from such integration, functional integration existed with respect to the operation of the division. There was also a large amount of centralized management. Since the ranch divisions are not separate and discrete business entities but part of a unitary business, the State was correct in taxing Ward, based on appropriation of Ward's total income.

The Montana divisions did not have the capacity to operate independent of Ward. The ranches depended upon the out-of-state operation for actual services including preparation of federal and state reports, tax returns and financial statements and hiring accountants to perform such services. The home office also kept all records and books and provided financing when funds in the ranch division expense account were insufficient. Further, the directors and officers controlled *all* divisions of Ward, including the ranch divisions. They approved or made *all* major decisions with respect to ranching activity such as buying equipment and buying and selling cattle. If such decisions were not made, the ranches simply would stand idle.

Further, we believe that Ward admitted that the ranches were part of a unitary business by utilizing the unitary business approach when filing corporation income tax forms in the other states where it operated. It considered the ranches part of its unitary business to set off income earned in those states with losses incurred in Montana. However, to minimize tax assessment in Montana, Ward asserted that it was a separate entity.

We also conclude that the standard utilized by the United State Supreme Court to determine if the subsidiaries in question were part of a unitary business is consistent with the standard codified in section 15-31-301(2),

MCA. As previously discussed, the Court focused upon the independence of the entity and whether it was capable of separate maintenance. Our statute also keys upon the dependence upon the "out of state" operation and whether the entity is capable of separate maintenance as an independent business.

Russell Stover also questions the constitutionality of the formula used to apportion to the state income to be taxed. We do not consider this issue for the following reasons. First of all, this question was not raised in the initial appeal to this Court. Second, the United States Supreme Court did not address this issue in its remand order. Finally, neither party adequately briefed this issue. In fact, the appellant mentions it for the sole purpose to insure that it is not deemed waived.

Affirmed.

FRANK I. HASWELL, Chief Justice

We Concur:
JOHN CONWAY HARRISON
DANIEL J. SHEA
L.C. GULBRANDSON
FRED J. WEBER
JOHN C. SHEEHY
FRANK B. MORRISON, JR.
Justices.

No. 81-2080

SUPREME COURT OF THE UNITED STATES

RUSSELL STOVER CANDIES, INC.,
Appellant,

v

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA.

APPEAL FROM THE SUPREME COURT OF MONTANA.

THIS CAUSE having been submitted on the statement of jurisdication and motion to dismiss,

ON CONSIDERATION WHEREOF, it is ordered and adjudged by this Court that the judgment of the above court in this cause is vacated with costs, and that this cause is remanded to the Supreme Court of Montana for further consideration in light of *F.W. Woolworth Co.* v. *Taxation & Revenue Department of New Mexico*, 458 U.S. __ (1982); and *ASARCO, Inc.* v. *Idaho State Tax Commission*, 458 U.S. __ (1982).

IT IS FURTHER ORDERED that the appellant, Russell Stover Candies, Inc., recover from Department of Revenue of the State of Montana Two Hundred Dollars ($200.00) for its costs herein expended.

October 4, 1982

Clerk's costs: $200.00

No. 80-375

IN THE SUPREME COURT OF THE
STATE OF MONTANA

1981

WARD PAPER BOX COMPANY, A Missouri corp.,
Respondent and Appellant,

— vs —

DEPARTMENT OF REVENUE OF THE STATE
OF MONTANA,
Appellant and Respondent

Appeal from:

District Court of the First Judicial District,
In and for the County of Lewis & Clark, The
Honorable Peter Meloy, Judge presiding.

Counsel of Record

For Appellant:
Terry B. Cosgrove, Helena, Montana
(Special Asst. Atty. General), Argued

For Respondent:

Ward A. Shanahan; argued, Helena, Montana
Gough, Shanahan, Johnson & Waterman, Helena,
Montana

Submitted: September 21, 1981
Decided: December 21, 1981

Filed: December 21, 1981

Thomas J. Kearney, *Clerk*

Mr. Chief Justice Frank I. Haswell delivered the Opinion of the Court.

This is an appeal by the Department of Revenue (DOR) from a judgment of the District Court of Lewis and Clark County vacating an assessment of additional corporation license taxes against the Ward Paper Box Company (Ward) for the years 1971 through 1975. We reverse.

Ward filed Montana corporation license tax returns for the years in question based on the segregated income from its Montana operations alone. DOR audited Ward's records, determined that Ward was a unitary business not entitled to separate accounting of its Montana operations and income, and assessed additional corporation license taxes against Ward by use of a three factor formula which apportioned to Montana a part of Ward's total income.

Ward protested this assessment to the State Tax Appeal Board (STAB). STAB affirmed the assessment by DOR. Ward filed a petition for review in the District Court of Lewis and Clark County. On August 4, 1980, the District Court reversed the STAB decision. DOR now appeals from the judgment of the District Court.

Ward is a Missouri corporation qualified and doing business in Montana, maintaining its principal place of business in Kansas City, Kansas. All of its common stock is owned by Mr. Louis Ward. Ward's activities consist of seven divisions; the divisions located outside of Montana are involved in manufacture, sale and distribution of paper boxes and paper box products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia. The Montana divisions consist of two cattle ranches, one in Meagher County and one in Powell County.

For the years 1971 through 1975, Ward used the separate accounting method for filing its Montana tax

returns and in each year paid the minimum corporation license tax of $50. During those years the operating costs and depreciation expenses of the Montana divisions exceeded the income earned by those divisions.

During the same time period, Ward filed tax returns under the unitary apportionment method in the other states in which it was operating and the Montana ranch divisions were included as part of its total unitary business. In those states the losses sustained by the ranch divisions were used to offset income earned by the paper box divisions.

The facts regarding Ward's operations during the years in question are for the most part uncontested. The home office in Kansas City provided administrative services for all divisions of Ward's operation which included preparing federal and state reports, hiring the accountants to prepare tax returns, keeping the books, preparing financial statements and balancing check books. Each of the divisions was charged an arbitrary figure of $60 per month for the home office services. This figure was not based on the amount of time actually spent on each division by the home office personnel.

Ward's divisions did not exchange equipment or personnel and did not purchase products jointly. There was no joint advertising program among the various divisions and no common salesmen.

There were two accounts maintained for each division, an expense bank account and a payroll account.

Each division's expense bank account was maintained in a bank in Kansas City. Any monies generated by a division were deposited in that division's separate expense account. If the division did not immediatley need the funds, they would be transferred from the separate division ex-

pense account into a general account and would be utilized wherever needed by any of the separate divisions. The president of the company would make the decision as to the transfer. Excess funds would be invested, if not needed by any of the divisions. A portion of the short-term investment income was attributable to funds generated in Montana, yet the portion attributable to funds earned in Montana could not be specifically identified or segregated.

If either of the Montana ranch divisions did not generate enough income to meet expenses, additional funds would be transferred from Ward's general account to the ranch division's expense bank account.

The payroll account for each ranch division was maintained in a Montana bank and checks could be written on the account by the ranch manager. However the home office personnel maintained the records, balanced the books, and made the deposits.

There was some central management of the corporation. From the evidence presented at the hearing, STAB found that the home office made all of the decisions regarding the financial affairs of the corporation and that major decisions regarding the ranches, such as the purchase of equipment and the buying and selling of cattle, required the approval of the chairman of the board or the president of the corporation.

Based on its findings regarding Ward's operation, STAB held that Ward was a unitary business and that the DOR had properly assessed the additional taxes against Ward. The District Court reversed the STAB decision, and DOR appeals.

Two issues are raised on appeal:

1. Whether the Montana ranch divisions were part of Ward's unitary business requiring Ward to apportion its

total income for Montana corporation and license tax purposes.

2. Whether the proper standard of review was used by the District Court in reviewing the STAB decision.

In order to resolve the first issue we must look at the pertinent statutory language in effect for the years 1971 through 1975, the years for which Ward was assessed additional corporation license taxes.

In 1971 and 1972 section 84-1503, R.C.M.1947, provided in pertinent part:

> "If the income of any corporation from sources within the state cannot be properly segragated from income without the state, then, in that event, the amount of the net income returned shall be that proportion of the taxpayer's total net income which the taxpayer's gross business done in the state of Montana bears to the total gross business of the taxpayer, and apportionment shall be made under the rules and regulations prescribed by the state board of equalization, giving consideration to sales, property and payroll and such other factors as may be deemed applicable. . ."

A 1973 amendment of this section substituted the words "department of revenue" for "board of equalization."

The section was amended again in 1974 and as amended stated in part:

> "A corporation engaged in a unitary business within and without Montana must apportion its business income. . . A business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as independent business[es]."

This same rule was found in the administrative regulations prior to the 1974 amendment of section 84-1503. The regulations which contained this rule were effective for tax years beginning on or after January 1, 1967.

In Mont. Dept. of Rev. v. Am. Smelting & Refining (1977), 173 Mont. 316, 567 P.2d 901 (hereinafter cited as ASARCO), this Court held that the purpose of the 1974 amendment was to clarify the statute; we stated that the unamended version of the statute was not in conflict with the regulations in effect prior to the 1974 amendment and we upheld the administrative regulations. Therefore, the rule quoted above applied during the entire period in dispute, first as an administrative regulation and then as a statute in which that regulation was codified.

If Ward was a unitary business, it was required to apportion its business income for the purpose of the Montana corporation license tax. If the business was unitary, the income from sources within Montana could not be "properly segregated" from income without the state.

Segregating the income by source does not necessarily "properly segregate" the Montana income from the out-of-state income thereby making the use of the separate accounting method proper, any statement in *ASARCO*, supra, that might be interpreted to the contrary notwithstanding.

The United States Supreme Court has declared that a state is not precluded from taxing a corporation under the apportionment method even if the source of income may be ascertained by separate geographical accounting as long as the intra-state and extra-state activities are part of a single unitary business. Mobil Oil Corp. v. Com'r of Taxes of Vermont (1980), 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510.

If the operation of Ward's business within Montana was dependent upon or contributory to its operation outside the state or if the Montana ranch divisions and the out-of-state paper box divisions were closely allied and not capable of separate maintenance as independent businesses, then the Montana ranch divisions were part of a "unitary business."

We find from the facts of this case that Ward's operation within Montana was dependent upon and contributing to its operation outside Montana. The Montana divisions were dependent upon the out-of-state operation for central services which included the preparation of federal and state reports, the hiring of accountants to prepare tax returns, the preparation of financial statements, the keeping of records, and the balancing of check books; for financing when funds in the ranch divisions' expense bank account were insufficient to meet the divisions' expenses; and for major management decisions which included the purchase of equipment and the buying and selling of cattle.

Ward's operation within Montana also contributed to its operation and net income outside the state. The Montana divisions furnished Ward with a substantial tax write-off thereby saving the corporation as a whole a substantial amount in taxes. Also a portion of Ward's short-term investment income was attributable to funds generated in Montana.

Since Ward's operation in Montana was both dependent upon and contributory to its operation outside the state, the Montana ranch divisions were part of Ward's unitary business during the years in question.

The respondent Ward contends that the DOR's assessment of additional taxes against it in this case is an attempt to subject income earned by Ward in other states to

the Montana corporation license tax in violation of the due process clause of the Fourteenth Amendment of the United States Constitution. We disagree.

The United States Supreme Court recently addressed this issue in *Mobil Oil Corp.*, 445 U.S. at 436-437, stating:

> "It long has been established that the income of a business operating in interstate commerce is not immune from fairly apportioned state taxation. (Cite omitted.) '[T]he entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing instate aspects of interstate affairs.' (Cite omitted.) For a State to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a 'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise. (Cite omitted.)"

The "minimal connection" or "nexus" is established "if the corporation avails itself of the 'substantial privilege of carrying on business' within the State. . ." *Mobil Oil Corp.*, 445 U.S. at 437, citing Wisconsin v. J.C. Penny Co. (1940), 311 U.S. 435, 444-445. Ward clearly availed itself of this privilege in Montana.

The "rational relationship" requirement is met in this case also. Ward was operated as a unitary business and as discussed earlier its operation in Montana was both dependent upon and contributory to its operation outside the state. Therefore, the portion of Ward's total income attributed to Montana under Montana's three-factor apportionment formula is rationally related to the intrastate value of the corporation.

The second issue raised by appellant DOR is whether the District Court used the proper standard of review of

STAB's findings and ruling. Since we are reversing the District Court judgment, this issue is irrelevant to a determination of this appeal.

The judgment of the District Court is reversed and the order of the State Tax Appeal Board entered October 1, 1979 in Docket No. CT-1978-3 is reinstated.

FRANK I. HASWELL, Chief Justice

We Concur:
GENE B. DALY
FRED J. WEBER
FRANK B. MORRISON, JR.
JOHN C. SHEEHY
Justices.

No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— vs —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

JUDGMENT ON REVIEW OF AGENCY ACTION

Filed: August 12, 1980

This matter involved an appeal from an Order of the State Tax Appeal Board entered October 1, 1979, in Docket No. CT-1978-3 and came before this Court on a Petition for Judicial Review by the taxpayer pursuant to Section 2-4-702, MCA, and Section 15-2-303, MCA, containing a statement of facts and specifying the grounds for review, and was filed pursuant to applicable law; and

This Court reviewed the record, heard oral argument of counsel, reviewed the written briefs and after having taken the matter under advisement, did on August 4, 1980, issue its Opinion and Order, a copy of which is attached hereto marked Exhibit "1" and which is by this reference incorporated herein;

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the Order of the State Tax Appeal Board in Docket No. CT-1978-3 be, and it is hereby reversed because the substantial rights of the Appellant taxpayer have been prejudiced as more particularly set

forth in Exhibit "1" and because the decision is clearly erroneous in view of the reliable, probative and substantial evidence on the whole record;

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the case be remanded to the State Tax Appeal Board for further proceedings in accordance with Exhibit "1".

DATED this 12th day of August, 1980.

GORDON R. BENNETT, District Judge

EXHIBIT "1"

No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— vs —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

OPINION and ORDER

Filed: August 4, 1980

This cause concerned the taxing of income by the State of Montana of Ward Paper Box Company.

It is agreed that the 14th Amendment of the United States Constitution prohibits a state from asserting a tax on income derived from business conducted beyond its border. However a situation arises wherein a corporation operates both within and without the state. In such a situation the legislature has provided one of two methods of taxation. One method is known as "separate accounting" and the other as the formula method.

Under the "separate accounting" method the corporation's activities within an individual state are treated entirely separate from the business activities outside the state.

The "formula" method treats the business activities within the state as part of the over-all business activities carried on by the corporation and considers the business

as "unitary" and apportions the taxable amount generally using three factors of value of property, amount of sales and amount of payroll.

The United States Supreme Court has considered the problem of the state's right to tax multi-state corporate activities but no clear rule has been established. However the formula method has been approved once it is determined that the business is unitary. Montana has by Supreme Court decision approved the formula method, the latest decision being *Department of Revenue v. American Smelting and Refining Company*, __M__, 567 P2d 901.

The question at bench is whether or not the petitioner can be classified as a "unitary operation."

Section 15-31-301 MCA provides the statutory definition of a "unitary" business as follows:

> "...a business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of a business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as a separate business."

The essential facts of Ward Paper Box's activities within and without the state are as follows:

1. Ward Paper Box Company is a Missouri chartered corporation and has its principal place of business in Kansas City, Kansas.

2. It has qualified to do business in the State of Montana.

3. The corporation is operated by divisions.

4. All out of Montana business concerned the manufacture, sale and distribution of paper boxes and paper box

products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia.

5. The sole Montana activity were two cattle ranch divisions, one in Meagher County and one in Powell County.

6. As to the ranching activities, the resident ranch manager made the day to day decisions but the major decisions such as the purchase of equipment, buying and selling of cattle required the approval of Mr. Lou Ward, Chairman of the Board, or Mr. Don Bowers, the president. The home office in Kansas City, through corporate personnel, made all decisions regarding the financial affairs of all divisions; prepared all federal and state reports (not including motor fuel reports); hired the accountants to prepare tax returns; kept all books; prepared all financial statements and balanced all checkbooks.

7. All divisions had the same operational supervision but there was no joint advertising program, no common salesmen, no common guaranties. Personnel of the various divisions did not move from one division to another, including managing staff. The divisions did not exchange equipment and did not purchase products jointly.

8. Each division had a payroll and expense account maintained in a bank in Kansas City. Whenever moneys were generated by a division they were deposited in the separate division account. If the division did not immediately need the funds, they would be transferred from the separate division's expense account into the Ward Paper Box general account and be utilized wherever needed in any of the separate division operations. The president would make the decisions as to transfer.

The Board of Tax Appeal concluded that there existed a unitary business consisting of two business activities,

namely ranching and paper box activities; that the ranch divisions were dependent on the out of Montana operation; that the ranch divisions were contributory to the operation of the out of Montana operations; that the ranch divisions' operations were closely aligned with the out of state operations; and that the ranch divisions "are not capable of separate maintenance as independent businesses from the operations of activities located outside the state."

The question before this Court is whether or not the business of Ward Paper Box is "unitary" within the meaning of the case law and the Montana statute. There is no essential dispute between the Department and the box company as to the facts of the relationship. The Department characterizes the Montana statutory definition of "unitary" as being composed of three separate tests and if the factual situation meets any one of the tests, the business activity is unitary and that the formula method is appropriate. These tests are (1) dependence, (2) contribution, (3) close alliance and not capable of separate maintenance.

As to the first test, it appears that there is some dependence by the ranch divisions on the out of state activities, although it appears that the ranch divisions could be separately maintained.

As to the second test, there is contribution in that the losses generated by the Montana operations are used by the out of state division for tax purposes and that any funds not used by the ranch divisions, if any, may produce income which could inure to the benefit of the out of state activities.

As to the third test, it appears that there is a close alliance in management and "cash flow" between the ranch divisions and the out of state activities.

The appellant contends that it has the right to make the tax return as it did, namely by separate accounting and that the conclusions of the State Tax Appeal Board are clearly erroneous in that they are not supported by substantial evidence within the meaning of Section 2-4-704 MCA.

As before stated and it is agreed that it is fundamental that a state has no power to impose a tax on income earned outside the state. Where, however, in the instance of an entity operating in more than one state the formula method can be used *if the activities can be classified as "unitary."*

The United States Supreme Court has, in the course of considering the question of unitary activities, used language which is appropriate for the facts considered and which sheds some light on the situation here considered.

In *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, the court held that the out of state income of a business that operates in more than one state is subject to examination by the taxing state only because of "the impossibility of allocating the profits earned by the processes conducted within its borders." (Underlining supplied).

In *Mobile Oil Corporation v. Commissioner of Taxes of Vermont* [sic], 48 U.S. Law Week 4306, the court said:

> "For a state to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a 'minimal' connection between the interstate activities and the taxing state, and a rational relationship between the income attributed to the state and the interstate values of the enterprise."
>
> "Nor do we find particularly persuasive Mobile's attempt to identify a separate business in its holding company function. So long as dividends from subsidiaries and affil-

> iates reflect profits derived from a functionally integrated enterprise, those dividends are income to the parent earned in a unitary business. One must look principally at the underlying activity not at the form of investment, to determine the propriety of apportionability." (Underlining supplied)
>
> "Where the business activities of the dividend payor have nothing to do with the activities of the recipient State, due process consideration might well preclude apportionability, because there would be no underlying unitary business."

In *Exxon Corp. v. Department of Revenue of Wisconsin* (United States Supreme Court, decided June 10, 1980), the court approved the apportionability of the Wisconsin statutes in a situation where Exxon was vertically integrated with a corporate structure divided into three parts namely Corporate Management, Coordination and Service Management, and Operations Management. The Wisconsin operation consisted of marketing products only. The court reiterated its previous holding that a company's internal accounting techniques are not binding on a state for tax purposes and restated the general rule that the due process clause imposes two requirements for state taxation "a minimal connection or nexus between the interstate activities and the taxing state, and *a rational relationship between the income attributed to the state and the intrastate values of the enterprise.*"

The appellant contends that a fundamental error occurred. It argues that the statutory standard of taxation arises from the words "income derived from or attributable to Montana sources" Section 15-31-101(3) MCA and it is only where necessary that 15-31-301 comes into effect (attribution of income). The appellant contends that the income sought to be taxed must have a Montana source — that is an activity must take place in Montana which contributes to income or upon which the overall

operation depends to produce income in a real way. It points out that the two operations of the tax payer here are separate, they do not share goods, supplies, sales, advertising, machinery, employees, technical assistance. It urges that the only real connections is that the monies originate at the same point and return to the same point which has been referred to as "cash flow."

The factual situation as disclosed by the record demonstrates that there is no impossibility of allocating the income between the Box activities and while there is minimal nexus between Box activities and the ranch activities, there is no real contribution by the ranches to the income of the Box activity.

To preserve the administrative function, the standard of review by the courts has been limited by statute, namely Section 2-4-704 MCA, wherein it states as follows:

> "(2) the court may not substitute its judgment for that of the agency as to the weight of evidence on questions of fact. The court may affirm the decision of the agency or remand the case for further proceedings. The court may reverse or modify the decision if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions or decisions are:
>
> (a) in violation of constitutional or statutory provision;
>
> (b) in excess of the statutory authority of the agency;
>
> (c) made upon unlawful procedure;
>
> (d) affected by other error of law;
>
> (e) clearly erroneous in view of the reliable, probative and substantial evidence on the whole record;
>
> (f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion; or
>
> (g) because findings of fact, upon issues essential to the decision, were not made although requested."

The Montana Supreme Court has in *Brurud v. Judge Moving and Storage Co., Inc.*, 172 M 249 set for the definition of "clearly erroneous" as follows:

> "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."

The Montana State Board of Tax Appeals has found the business to be unitary and it is the view of this Court that such finding is clearly erroneous. Fundamentally the rationale of the unitary tax concept as approved by the United State Supreme Court directs the look of the court to the "underlying activity not at the form of investment, to determine apportionability." (*Mobile Oil Corporation v. Commissioner of Taxes of Vermont*, supra.) [sic].

In the controversy under consideration here the activities of the appellant which produce income unrelated to the Montana activities, and which the State seeks to tax, are distinctly separate. The contribution of the ranch activity to the income from the paper box activity, if any, is slight.

The position of the State here is an unwarranted extension of the "unitary concept" and violates the basic rationale of the unitary concept.

This Court finds and concludes that the decision of the State Tax Appeal Board is clearly erroneous and therefore should be reversed and remanded to the State Tax Appeal Board for further proceedings in accord with this opinion.

Let judgment be entered accordingly.

Dated this 4th day of August, 1980.

PETER G. MELOY, District Judge

cc to: Counsel of record

Docket No. CT-1978-3

BEFORE THE STATE TAX APPEAL BOARD OF THE STATE OF MONTANA

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— vs —

THE DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

Hearing on the appeal of Ward Paper Box Company, pursuant to Sections 2-4-601 and 15-2-302, M.C.A., came on regularly for hearing before the Board on April 23, 24, 1979, in the City of Helena, Montana, from a decision of the Department of Revenue denying Appellant's request to set aside the deficiency assessment levied against said Appellant and the decision of the Department of Revenue in treating Appellant as a unitary operation and requiring formula apportionment of all of Appellants income for the taxable years 1971 through 1975, the Appellant, Ward Paper Box Company, appearing through its attorney, Ward A. Shanahan, of the firm of Gough, Shanahan, Johnson & Waterman, Helena, Montana; and the Department of Revenue being represented by Terry B. Cosgrove, Special Assistant Attorney General; and the Board having heard the testimony and have examined all of the evidence and the briefs offered by all parties, and the Board being fully advised in the premises, does hereby make its Findings of Fact, Conclusions of Law and Order as follows:

FINDINGS OF FACT

I.

Ward Paper Box Company is a corporation organized and existing under the laws of the State of Missouri, duly authorized and qualified to do business in the State of Montana with its principal place of business at 3150 Chrysler Road, Kansas City, Kansas. The President of the company, Mr. Don E. Bowers, has his office there.

II.

The company operated in its corporate capacity in Montana and received services from the State of Montana, through its divisions, the Castle Mountain Ranch Division in Meagher County, Montana, which was purchased on December 1, 1969, and the Rock Creek Cattle Company Division in Powell County, Montana, which was purchased on December 1, 1972. These divisions produce livestock, hay, forage and other crops solely in Montana and operate in Montana and no other state.

III.

The corporation also operated several paper box divisions which, during the taxable years in question, manufactured, distributed and sold paper boxes and paper box products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia. During the audit period, none of these divisions in any way engaged in the business of manufacturing, distributing or selling paper boxes or paper box products in the State of Montana or engaged in the business of agriculture or the business of producing livestock, hay, forage or other crops in the state of Montana, or in any other state.

IV.

The Department of Revenue, pursuant to a notice of deficiency, assessed a deficiency against the taxpayer

under the Montana Corporation License Tax for the years 1971, 1972, 1973, 1974 and 1975.

V.

The taxpayer had been filing its returns in the state of Montana utilizing the method of separate accounting.

VI.

The Taxpayer's ranching activities are limited solely to the state of Montana; but said Taxpayer has filed its tax returns in the states of Missouri, Kansas, Colorado, South Carolina and Virginia under the method of unitary apportionment of its total net income, including as a portion of its regular business income, the income and expenses from the ranch activities and apportioning that income to the other states.

VII.

In the "sales factor" of the three-factor formula used by the Department of Revenue, Montana sales of livestock, hay and some gravel are compared with all sales, including sales in other states of paper boxes and paper box products for the taxable years in question.

VIII.

In the "payroll factor" of the three-factor formula used by the Department of Revenue for the taxable years in question, the salaries and benefits paid to ranch supervisors, supervisory personnel and all employees in the state of Montana were compared to all employees of the company everywhere.

IX.

In the "property factor" of the three-factor formula used by the Department of Revenue for the taxable years in question, the property owned and located in the State of Montana is compared to the property owned by the company and located elsewhere.

X.

During the period of the audit, the sales factor representing the Montana sales, equaled the following percentage of the taxpayers total sales: 1971 - 4.9%; 1972 - 1.1%; 1973 - 6.5%; 1974 - 6.6%; and 1975 - 7.3%.

XI.

During the period of the audit, the payroll factor representing the Montana payroll, equaled the following percentages of the taxpayers total payroll: 1971 - 3.2%; 1972 - 5.9%; 1973 - 11.3%; 1974 - 11.7%; and 1975 - 15.5%.

XII.

During the period of the audit, the property factor representing the Montana property, equaled the following percentages of the taxpayers total property: 1971 - 50.6%; 1972 - 64.4%; 1973 - 70.5%; 1974 - 67.3%; and 1975 - 68.1%.

XIII.

The Montana payroll, property and sales during the period of the audit equaled the following percentages of the companys total payroll, property and sales: 1971 - 19.6%; 1972 - 23.8%; 1973 - 29.4%; 1974 - 28.5%; and 1975 - 30.3%.

XIV.

During the years in question, the ranch manager had decision making authority on the day to day ranch operations; however, for matters outside of the day to day activities, including, but not limited to, the purchase of equipment, or buying or selling cattle, such decisions required approval from either Mr. Louis Ward, Chairman of the Board or Mr. Don Bowers, President of the company.

XV.

The home office, located in Kansas City, Missouri, made all decisions regarding the financial affairs of the

corporation, the home office also provided and prepared for all of the divisions including Montana, the federal and state reports (other than motor fuel) which were filed; the home office also hired the accounting firm of Touche and Ross to prepare all federal and state tax returns; the home office also kept all of the books, prepared all financial statements, and balanced all checkbooks. All divisions of the corporation, including the ranch divisions, were charged an arbitrary figure of $60.00 per month for all home office services. This figure was not based upon any allocation of time spent by any of the home office personnel, and had been in use prior to the time of the audit.

XVI.

The Montana divisions could not account for their total actual expenses in as much as an arbitrary $60.00 a month figure is charged for home office services, which bears no relation to the actual time expended, and was allocated throughout the company on that same basis without any regard to what the actual charge should be to a particular division.

XVII.

The Chairman of the Board and principal stockholder, Mr. Louis L. Ward, visited Montana the following listed number of times during the years in question, according to a log kept of the movements by the company aircraft:

1971 — 8 trips to Helena, 1 to Billings
1972 — 12 trips to Helena
1973 — 5 trips to Helena
1974 — 6 trips to Helena
1975 — 6 trips to Helena

XVIII.

A Mr. J. Tschudy was hired by the company as a consultant in ranch properties in 1968. He visited the Castle Mountain Ranch in Meagher County several times. His

permanent office was in Kansas City, Kansas. Mr. Tschudy died in 1972, his compensation was included in wages and salaries claimed as deductions for the Montana ranch operations in 1971 and 1972.

XIX.

During the period of the audit the ranch and box divisions had the same operational supervision, there was no joint advertising program among any of the divisions of the corporation, there were no common salesmen for any of the divisions of the corporation, there were no common guarantees for any of the divisions of the corporation, personnel from the various divisions did not move from one division to another, including managing staff; the various divisions did not exchange equipment; the divisions did not purchase products jointly whether for the ranch or box operations.

XX.

During the period of the audit the ranch personnel consisted of employees working exclusively on specific ranch projects; no accounts, bookkeepers or office employees were employed at either ranch divisions during the period of the audit.

XXI.

Each division had a payroll account and an expense account. The expense accounts were maintained in a bank in Kansas City, and whenever monies were generated by a division they were deposited in the separate division expense account. If the division did not immediately need the funds, they would be transferred from the separate division expense account into the Ward Paper Box general account and be utilized wherever needed in any of the separate division operations. The determination of whether or not funds would be transferred from the divi-

sion expense account to the Ward general account was made by the President of the company.

XXII.

The ranch divisions maintained a payroll account in a Montana bank, however the ranch manager did not know the balance of the account, he merely would write the payroll checks and forward the information to the home office where the records were maintained, the books balanced and deposits originated. The ranch manager would not make deposits in the payroll account, those decisions were made at the home office. Limits on the size of a check a ranch manager could write were set by the Board of Directors of the Company.

XXIII.

During the period of the audit, monies would be transferred from the separate division expense account, including the Montana divisions, to the Ward general account for the purpose of making short term investments.

XXIV.

The investment income earned by the taxpayer, a portion of which was attributable to the funds generated in Montana, was reported only in the State of Missouri, and could not be segregated as to source including that portion attributable to the income generated in Montana.

XXV.

The ranch operations did not generate sufficient cash inflow generated from the company's other operations, during the audit period: 1971 - $752,693.00; 1972 - $4,535,597.00 — this did include $3,300,000.00 for the purchase of the Rock Creek Division, so the actual cash inflow needed apart from the ranch acquisition was $1,235,597.00; 1973 - $938,931.00; 1974 - $1,268,146.00; and 1975 - $819,984.00 [sic].

XXVI.

Funds exceeding those generated from the ranch divisions necessary to pay ranch expenses would be transferred from the Ward general account to the ranch expense account.

XXVII.

Funds from the ranch divisions when transferred to the Ward general account were co-mingled with other funds of the company.

XXVIII.

The taxpayer never requested under the provisions of Section 15-31-312, M.C.A., for the use of a different apportionment formula or for modification of the formula, only for the right to use separate accounting.

XXIX.

The taxpayer has had the opportunity to examine all information utilized by the Department in making its determination of the deficiency assessment.

CONCLUSIONS OF LAW

I.

The taxpayer has income arising from business activities both within and without the state of Montana.

II.

The corporation is engaged in two business activities.

III.

The operation of the ranch divisions within the state is dependent upon the operations of the company located outside the state.

IV.

The operation of the ranch divisions within the state is contributory to the operation of the divisions outside the state.

V.

The operation of the ranch divisions within the state is closely aligned with the operations of the taxpayer located outside the state.

VI.

The operations of the ranch divisions are not capable of separate maintenance as independent businesses from the operations of the activities located outside the state.

VII.

A flow of goods within a corporation is not necessary in order to have a unitary business operation.

VIII.

The taxpayer is operating a unitary business as defined by the statutes and regulations of the Corporation License Tax Act.

IX.

A unitary business is not able to properly separately account for its income or expenses.

X.

The taxpayer cannot properly segregate income or expenses directly attributable to the State of Montana.

XI.

The taxpayer has been improperly filing on the separate accounting basis, and is required to file on the apportionment method, utilizing the factors of payroll, property and sales.

XII.

The Department of Revenue has properly taxed income which is in fact derived from or attributable to Montana sources.

XIII.

The formula utilized by the Department in computing the net income attributable to the taxpayer, is ration-

ally related to the values provided by the state to the taxpayer.

XIV.

The deficiency assessment levied by the Department and its determination that the operations of the taxpayer are unitary, does not exceed the power of the Department to access [sic] and levy a tax pursuant to the laws of the State of Montana, and does not result in a taxation upon income earned in other states, and is not a taking of property without due process of law in violation of either the 5th or 14th Amendments of the Constitution of the United States and the applicable provisions of the Montana Constitution.

XV.

The regulation 42-2.6(1)-S6270, was properly adopted and effective for the years in question.

XVI.

The regulation 42-2.6(1)-S6450 and regulations 42-2.6(1)-S6280 and 42-2.6(1)-S6450 do not exceed the scope of the authority of the Department of Revenue, and were properly adopted and effective for the years in question.

XVII.

The action of the Department of Revenue in no way denies the taxpayer equal protection under the laws guaranteed to it by the 14th Amendment to the Constitution of the United States.

XVIII.

That the method utilized by the taxpayer of filing its corporate returns in other states is relevant to the inquiry of determining in the State of Montana how the taxpayer should be reporting.

XIX.

That the taxpayer has not properly reported its income in accordance with the Montana Corporation License Tax effective for the taxable years in question.

ORDER

Based on the above Findings of Fact and Conclusions of Law, IT IS HEREBY ORDERED:

1. That the taxpayers appeal from the decision of the Department of Revenue is denied.

2. That the Appellant herein pay all Montana Corporation license taxes herein assessed, and interest, as properly imposed by the laws of the State of Montana.

DATED this 1st day of October, 1979.

BY ORDER OF THE STATE TAX APPEAL BOARD

HELEN M. PETERSON, Chairman

ROBERT S. RAUNDAL, Member

JAMES A. STEFFECK, Member

IN THE MATTER OF THE PROTEST OF
WARD PAPER BOX COMPANY

Proposed Deficiency Assessments of
Corporate License Tax For Calendar Years
1971, 1972, 1973, 1974 and 1975

HEARING OFFICER:

John Clark, Administrator, Research Division, Department of Revenue, Mitchell Building, Helena, Montana 59601

DATE OF HEARING:

December 28, 1977, at 10:00 o'clock a.m., continued to April 6, 1978, at 9:00 o'clock a.m.

PLACE OF HEARING:

Mitchell Building, Helena, Montana

PRESENT FOR THE TAXPAYER:

Mr. Ward Shanahan, of Gough, Shanahan, Johnson & Waterman, First National Bank Building, P.O. Box 1686, Helena, Montana 59601

PRESENT FOR THE DEPARTMENT:

Mr. Terry Cosgrove and Mr. Robert Corcoran, Counsel for the Montana Department of Revenue

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The controversy in question arises out of the determinations of Montana Corporate License Tax dated June 1, 1977 concerning Ward Paper Box Company's liability for the years ending December 31, 1971 through December 31, 1975 inclusive. These determinations were based on an audit conducted by staff of the Corporation License Tax Division for the Montana Department of Revenue for the State of Montana.

The foregoing letters of determination disclose the following corporate license tax liability due the State of Montana from Ward Paper Box Company (hereafter Ward) as of May 30, 1977.

	1971	1972	1973	1974	1975
Tax due per audit	$26,045.	$29,690.	$31,167.	$35,532.	$44,770.
Interest at 9%					
5/15/72-5/30/77	11,818.				
5/15/73-5/30/77		10,800.			
5/15/74-5/30/77			8,532.		
5/15/75-5/30/77				6,529.	
5/15/76-5/30/77					4,197.
	$37,863.	$40,490.	$39,699.	$42,061.	$48,967.
GRAND TOTAL	$209,080.				

By letter dated June 29, 1977 received by the Montana Department of Revenue (hereinafter the Department) on June 29, 1977, Mr. Ward A. Shanahan, counsel for Ward, filed a protest against the foregoing determinations and requested an opportunity to have an oral hearing and the right to present additional evidence.

Mr. Shanahan contended that the company operates in Montana through two divisions, Castle Mountain Ranch division and Rock Creek Cattle Company division an agricultural business producing livestock, hay, forage and other crops. Mr. Shanahan further contended that the Paper Box Division is a wholly separate division which did not engage in business in the State of Montana or engage in the business conducted by the divisions in the State of Montana. Further, that the income of the taxpayer from sources within the state is properly segregable; that regulation 42-2.6 (1)-S.6270 was not adopted or effective for the years 1971 and 1972; that the same regulation purports

to adopt a uniform act which has not been adopted by the legislature; that regulations 42-2.6 (1)-S.620 through 42-2.6 (1)-S.6450 exceeded legislative authority and therefore was not effective in the years in question; that the activities of the taxpayer are separate and distinct from the other activities not part of a unitary business and the business conducted within the state is not dependent upon or contributory to the business conducted outside the state; that the elements of common ownership; use of centralized facilities, centralized management and decision making are not sufficient to establish unitary business; and that the actions of the Department exceeded the regulations of the Department, exceed statutory authority and are not based upon sufficient facts and are otherwise arbitrary.

As a result of the protest, an informal conference was held on August 22, 1977, between representatives of Ward and the Corporation License Tax Division at which time it was determined that there was no prospect of a settlement of this matter and the taxpayer by letter dated September 16, 1977 further requested an oral hearing on this matter.

By letter dated November 1, 1977 Mr. Shanahan was notified of the hearing which was subsequently held on December 28, 1977. At the hearing questions were raised as to the propriety of Mr. Foster conducting the informal hearing of this matter and to the nature and procedure of the hearing.

At the hearing the taxpayer agreed to supply tax returns filed in other states in which it operates its box divisions but no cattle operations, and filed an additional protest of the proposed action of the Corporation License Tax Division.

The hearing was adjourned until a further date.

By letter dated March 15, 1978 Mr. Shanahan was informed that the hearing would be reconvened but that due to the allegation that Mr. Foster could not properly hear this matter, Mr. John Clark, Administrator, Research Division, was appointed as the informal hearings officer.

The hearing was reconvened on April 6th at 9:00 o'clock at which time the taxpayer was given the opportunity to present any additional information relating to the proposed deficiency.

During the foregoing proceedings, Ward has been given every opportunity to produce any documents or other evidence it wished to have considered in conjunction with the hearing. The department relied on the materials submitted by the taxpayer to resolve the questions at issue at the hearing.

It is important to again review the nature of the hearing contemplated by section 84-1508.1. This question was specifically raised and decided by the Montana Supreme Court in the case of *W.R. Grace and Co., vs. the Department of Revenue of the State of Montana*, 34 St. Rep. 713, __P2d__ (1977). There the Montana Supreme Court very clearly defined the scope and extent of this hearing when it said:

> "As stated above, Section 84-1508.1 does not provide a true adversary hearing, but only for a presentation of additional evidence by the taxpayer and a reconsideration by DOR thereafter." Page 716.

Under this mandate from the Supreme Court of Montana, it is necessary then to weigh the additional information provided by the taxpayer to determine if there is just cause for a reconsideration of the proposed assessment.

The taxpayer has not questioned the calculations of the Department in proposing the deficiency assessment but

has limited its arguments solely to the legal authority of the Department to require the taxpayer to file a unitary tax return.

The authority of the Department to require the filing of a unitary tax return is derived in Section 84-1503 R.C.M. 1947 and the regulations adopted by the Department. Under the statute 84-1503, prior to its amendment in 1974, a corporation was required to file its returns based on the separate accounting method only if, "the income of any corporation from sources within the state cannot be *properly* segregated from income without the state". To determine whether a corporation can properly separately account, it is necessary to look at the regulations which were in effect prior to the 1974 amendment. These provide that any corporation which conducts a unitary business within and without the State of Montana must apportion its business income. The regulations further provide that "a business is unitary when the operation of the business within the state is *dependent upon*. . . the operation of the business outside the state". That language was subsequently enacted into the amended section of 84-1503.

Whether or not those regulations were valid was decided by the Supreme Court of Montana in the case of *Montana Department of Revenue vs. American Smelting and Refining Company*, 34 St. Rep. 597, __P2d__ (1977), wherein the Court stated:

> "The crux of this entire case is the interpretation of Section 84-1503 and DOR regulations 1001-1020. There is no merit in ASARCO's contention that DOR has only authority to adopt rules and regulations for the apportionment of income incapable of segregation as to source."

The entire question then of the validity of the audit rests upon a determination of whether or not the taxpayer is

conducting a unitary business. If the taxpayer is conducting a unitary business as defined by the regulations adopted by the Department prior to 1974 and by the legislative enactment thereafter, then the taxpayer must file using the unitary method. The taxpayer in its protest claimed that it could separately account and that the Department did not question that it could so separately account. The Department specifically denies the taxpayer can properly separately account. The taxpayer may try to maintain separate books and records, but such is not sufficient under the statute or regulations.

Are then the business activities of the taxpayer within the State of Montana dependent upon the operations of the taxpayer outside the State of Montana? Traditionally there have been two tests utilized for the determination of whether or not a corporation operates a unitary business. The first test is a determination of the existence of the three unities (unity of ownership, unity of operation and unity in a centralized executive force) which was used in the case of *Butler Bros. vs. McColgan*, 315 U.S. 501, (1942) and relied upon by the taxpayer. However, the test embodied by the regulations and statutes involved herein, is the contribution or dependency test as used in *Edison, California vs. McColgan*, 183 P2d 16 (1947). In what ways then are the activities of the cattle operations in Montana dependent upon the general manufacturing operation?

Consider the following facts. Supervision of the cattle operation is conducted by Mr. Lewis Ward, President of Ward Paper Co. who determines the size of herds, oversees cattle purchases, negotiates land purchases and has final approval on all major cattle purchases. Construction of any facilities in the Montana operation require prior approval from the home office. Purchases of any equipment

require prior approval from the home office. Whether or not feed for the cattle will be purchased and how the land is to be utilized rests with final approval of Mr. Ward. All major ranch expenses are approved at the home office. Ranch managers are limited as to the checks which can be written on various ranch accounts; they are given a fixed number of blank checks with which to work. Generally, ranch supplies are ordered and billed directly to the home office. The home office provides payments for all farm vehicle insurance on ranch properties. Capital with which the ranches were purchased was provided by stock dividends in the Russell Stover Candy Company owned by the taxpayer. Operating capital is provided by the taxpayer since the ranch divisions have continued to sustain operating losses. Home office personnel and accountants in Kansas City prepare federal tax returns, financial statements, fuel tax reports, U.C.C. reports, workman's compensation reports and payroll data. Although ranch managers sign the payroll checks, the checks are prepared from the home office. The home office prepares the books and handles payroll for the ranch operations. Each ranch division is allocated an arbitrary overhead charge of $60.00 per month for general and administrative costs, but allocation is not based on hours spent. Insurance for the ranch properties is arranged by the home office through a national agent.

There appears no doubt that the operations of the ranch division are highly dependent on the operations of the home office. Strong centralized management is indicative of a unitary operation. When, as here, there is strong central management in conjunction with the centralization of functions such as financing, accounting, research and purchasing, it is indicative of a single unitary business. It is true that in this case there is no intercompany flow of goods but such a requirement is not absolutely necessary

if the other elements of a unitary business are present. *Superior Oil Co. vs. Franchise Tax Board*, 386 P2d 33, *Honolulu Oil Co. vs. Franchise Tax Board*, 386 P2d 40 (1963). In *Zale - Salem Inc. vs. State Tax Commission*, 391 P2d 601 (1964) the Supreme Court of Oregon found that a unitary business was present when a parent corporation provided the following services for its wholly owned subsidiaries: central buying and manufacturing; central management, accounting, advertising, legal and other services; strict accounting, management control and supervision; paychecks and other disbursements handled by central office; control over personnel including the hiring, training and firing; requirement that the manager of each local corporation submit a daily accounting; all monies received deposited in a local bank and can only be withdrawn by officers of the parent; financial and management interests of the separate corporations conducted by the parent. That case involved a situation dealing with a parent and subsidiary corporations operating in one unitary framework, however, the principals are applicable when separate divisions of a corporation operate within the same framework as is in the present situation.

In addition, the taxpayer provided copies of its state income tax returns filed in the states of Kansas, Missouri and Colorado showing that in those states it is filing on the unitary method claiming the cattle division as a portion of the unitary activities of the corporation, when by the taxpayers own admission, there were no cattle operations conducted in those states.

CONCLUSION

For the reasons herein stated, it is the determination of the Department, after reconsideration, that the assessments proposed in the determination letter of May 30, 1977 are correct.

Respectfully submitted.
JOHN CLARK, Hearing Officer

APPENDIX B

Cause No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

STIPULATION FOR STAY, JUDGMENT AND EXECUTION

COME NOW the parties, pursuant to Montana Rules of Civil Procedure and the Montana Rules of Appellate Civil Procedure, and stipulate as follows:

I

That Respondent and Appellant Ward Paper Box Company recovered a judgment in this court in this action which was appealed to the Montana Supreme Court by The Department of Revenue of the State of Montana. That the judgment was reversed by the Order of the Supreme Court in Docket No. 80-375 and remittitur was returned to this court on or about January 25, 1982, following denial of petition for rehearing; and

II

That Respondent and Appellant taxpayer Ward Paper Box Company raised constitutional issues and federal questions related thereto in this proceeding before the State Tax Appeal Board, this court and the Supreme Court

of Montana, and the taxpayer has advised the Department of Revenue it intends to file an appeal and make application for writ of certiorari pursuant to 28 U.S.C. and the Rules of the Supreme Court of the United States and would be entitled to stay entry of judgment herein and to stay the issuance of a writ of execution for the tax liability due pursuant to Fed. R. Civ. P. 50-51 pending lodging of an appeal or application for the writ of certiorari, but Department of Revenue is satisfied ample security is present within the jurisdiction against which the department could enforce its judgment and recover tax and interest due and, therefore;

III

IT IS HEREBY STIPULATED that the entry of judgment on remittitur and issuance of levy of execution pursuant thereto will be considered stayed pending the expiration of time allowed in filing an appeal and making application for writ of certiorari to the Supreme Court of the United States with respect to the constitutional issues and federal questions raised in this matter.

DATED this 2 day of February, 1982.

GOUGH, SHANAHAN, JOHNSON & WATERMAN

Ward A. Shanahan
Attorneys for Ward Paper Box Company
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715

DEPARTMENT OF REVENUE, STATE OF MONTANA

By: Terry B. Cosgrove
Special Assistant Attorney General
P.O. Box 1144
Helena, MT 59624-1144

ORDER

The Court having viewed the foregoing stipulation, the Montana Rules of Civil Procedure and the Rules of Appellate Civil Procedure and, in particular, Rule 7 thereof, and being duly advised in the premises, does hereby;

ORDER that entry of final judgment in this matter and issuance of stay thereon be, and they are hereby stayed pending application for Appeal or Writ of Certiari to the Supreme Court of the United States with respect to the constitutional issues and federal questions raised herein [sic].

DATED this 2 day of February, 1982.

PETER MELOY, District Judge

80-375

D.C. No. 44457

IN THE SUPREME COURT OF THE
STATE OF MONTANA
March Term A.D. 1983

Filed: 83 Jul 11

The Chief Justice of the Supreme Court of the State of Montana:

To the Honorable Judge of the District Court of the First Judicial District, in and for the County of Lewis and Clark. Greeting:

WHEREAS, In the said District Court in a cause between Russell Stover Candies, Inc., a Missouri corporation, Respondent and Appellant and Department of Revenue of the State of Montana, Appellant and Respondent wherein the judgment of the said District Court, entered in said cause on the 12th day of August A.D. 1980 was in favor of the said Respondent and Appellant and against the said Appellant and Respondent as by the inspection of the transcript of the record of said Court in said cause which was brought into the Supreme Court of said State by virtue of an appeal, agreeably to the statute of said State and the rules of said Supreme Court in such case made and provided, fully and at large appears.

AND WHEREAS, in the March term of court in the year of our Lord, one thousand nine hundred and eighty-three said cause came on to be heard before said Supreme Court and was argued by counsel.

WHEREUPON, On consideration, it is now here ordered and adjudged by this Court that the Judgment of the Court below, entered in this cause on the 12th day of

August A.D. 1980 is affirmed.

Costs in this Court:
Appellant Appearance - $ no fee
Respondent Appearance - $ 10.00
Remittitur ---------- $ no fee

May 19 A.D. 1983

You, THEREFORE, are hereby commanded that such further proceedings be had in said cause as, according to right and justice, and the laws of the State of Montana ought to be had, not inconsistent with the opinion hereto attached.

WITNESS: The Honorable Frank I. Haswell, Chief Justice of the Supreme Court of the State of Montana, this 7th day of July A.D. 1983

PHYLLIS NEILD
Deputy Clerk of the Supreme Court of the State of Montana

No. 80-375

IN THE SUPREME COURT OF THE
STATE OF MONTANA

RUSSELL STOVER CANDIES, INC., a Missouri corporation,
Respondent and Appellant

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Appellant and Respondent.

ORDER

Filed: Jul 7, 1983

PER CURIAM:

The petition for rehearing is denied.

DATED this 7th day of July, 1983.

FRANK I. HASWELL, Chief Justice
JOHN CONWAY HARRISON
DANIEL J. SHEA
JOHN C. SHEEHY
FRANK B. MORRISON, JR.
L.C. GULBRANDSON
Justices

APPENDIX C

Cause No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

RUSSELL STOVER CANDIES, INC., a Missouri corporation,

Respondent and Appellant,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Appellant and Respondent.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Filed: Aug. 19, 1983

Notice is hereby given that Russell Stover Candies, Inc., the Respondent above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Montana, ordering judgment in favor of the Appellant, Department of Revenue of the State of Montana, entered in this action on May 19, 1983

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated this 19th day of August, 1983.

GOUGH, SHANAHAN, JOHNSON & WATERMAN

Ward A. Shanahan

Attorneys for Respondent and Appellant

301 First National Bank Building

P.O. Box 1715

Helena, MT 59624

CERTIFICATE OF SERVICE

I, Ward A. Shanahan, one of the attorneys for Russell Stover Candies, Inc., the Respondent and Appellant in the above-entitled action, do hereby certify a copy of the foregoing Notice of Appeal to the Supreme Court of the United States was mailed, postage fully prepaid thereon at Helena, Montana, on the 19th day of August, 1983, and directed to the following attorneys:

Mr. Terry B. Cosgrove
Mr. Michael B. Rieley
Montana Club Building
P.O. Box 1144
Helena, MT 59624

WARD A. SHANAHAN

1475D

No. 80-375

IN THE SUPREME COURT OF THE
STATE OF MONTANA

RUSSELL STOVER CANDIES, INC., a Missouri corporation,
Respondent and Appellant,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Appellant and Respondent.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Filed: Aug 19, 1983

Notice is hereby given that Russell Stover Candies, Inc., the Respondent above named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Montana, ordering judgment in favor of the Appellant, Department of Revenue of the State of Montana, entered in this action on May 19, 1983.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated this 19th day of August, 1983.

GOUGH, SHANAHAN, JOHNSON & WATERMAN
Ward A. Shanahan
Attorneys for Respondent and Appellant
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624

CERTIFICATE OF SERVICE

I, Ward A. Shanahan, one of the attorneys for Russell Stover Candies, Inc., the Respondent and Appellant in the above-entitled action, do hereby certify a copy of the foregoing Notice of Appeal to the Supreme Court of the United States was mailed, postage fully prepaid thereon at Helena, Montana, on the 19th day of August, 1983, and directed to the attorneys listed below; and do further certify that all parties required to be served have been served:

Mr. Terry B. Cosgrove
Mr. Michael B. Rieley
Montana Club Building
P.O. Box 1144
Helena, MT 59624

WARD A. SHANAHAN

1475D

APPENDIX D

Cause No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY,

Plaintiff,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Defendant.

MOTION FOR SUBSTITUTION OF PARTIES

COME NOW, Russell Stover Candies, Inc., a Missouri corporation, by and through its counsel, Ward A. Shanahan of the firm of Gough, Shanahan, Johnson & Waterman, pursuant to M. R. Civ. P. 25(c) and moves this Court for an order directing the substitution of Russell Stover Candies, Inc., a Missouri corporation, for Plaintiff, Ward Paper Box Company. This motion is made upon the grounds and for the reasons that Ward Paper Box Company has been merged into Russell Stover Candies, Inc., and the surviving corporation, Russell Stover Candies, Inc., has succeeded to all the interests of Ward Paper Box Company.

Counsel for Defendant, Department of Revenue, has been informed of this motion, has no objection to the granting of the motion and has filed a waiver of hearing of this motion.

Dated this 19th day of March, 1982.

GOUGH, SHANAHAN, JOHNSON & WATERMAN

Ward A. Shanahan
Attorneys for Respondent and Appellant
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715

ORDER

Upon Motion of counsel for Plaintiff, Ward Paper Box Company,

IT IS HEREBY ORDERED that Russell Stover Candies, Inc., a Missouri corporation, having succeeded to the interests of Ward Paper Box Company, be substituted as Plaintiff in the above-entitled action, which shall henceforth be styled, "Russell Stover Candies, Inc., a Missouri corporation, Plaintiff, v. Department of Revenue of the State of Montana, Defendant."

Dated this 19th day of March, 1982.

PETER G. MELOY, District Judge